

(c) *Forgiveness of indebtedness treated as an amount paid.* If an indebtedness that has been treated as an amount paid under § 1.83-1(a)(1)(ii) is subsequently cancelled, forgiven or satisfied for an amount less than the amount of such indebtedness, the amount that is not, in fact, paid shall be includible in the gross income of the service provider in the taxable year in which such cancellation, forgiveness or satisfaction occurs.

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§ 1.83-5 Restrictions that will never lapse.

(a) *Valuation.* For purposes of section 83 and the regulations thereunder, in the case of property subject to a nonlapse restriction (as defined in § 1.83-3(h)), the price determined under the formula price will be considered to be the fair market value of the property unless established to the contrary by the Commissioner, and the burden of proof shall be on the commissioner with respect to such value. If stock in a corporation is subject to a nonlapse restriction which requires the transferee to sell such stock only at a formula price based on book value, a reasonable multiple of earnings or a reasonable combination thereof, the price so determined will ordinarily be regarded as determinative of the fair market value of such property for purposes of section 83. However, in certain circumstances the formula price will not be considered to be the fair market value of property subject to such a formula price restriction, even though the formula price restriction is a substantial factor in determining such value. For example, where the formula price is the current book value of stock, the book value of the stock at some time in the future may be a more accurate measure of the value of the stock than the current book value of the stock for purposes of determining the fair market value of the stock at the time the stock becomes substantially vested.

(b) *Cancellation—(1) In general.* Under section 83(d)(2), if a nonlapse restriction imposed on property that is subject to section 83 is cancelled, then, unless the taxpayer establishes—

(i) That such cancellation was not compensatory, and

(ii) That the person who would be allowed a deduction, if any, if the cancellation were treated as compensatory, will treat the transaction as not compensatory, as provided in paragraph (c)(2) of this section, the excess of the fair market value of such property (computed without regard to such restriction) at the time of cancellation, over the sum of—

(iii) The fair market value of such property (computed by taking the restriction into account) immediately before the cancellation, and

(iv) The amount, if any, paid for the cancellation, shall be treated as compensation for the taxable year in which such cancellation occurs. Whether there has been a noncompensatory cancellation of a nonlapse restriction under section 83(d)(2) depends upon the particular facts and circumstances. Ordinarily the fact that the employee or independent contractor is required to perform additional services or that the salary or payment of such a person is adjusted to take the cancellation into account indicates that such cancellation has a compensatory purpose. On the other hand, the fact that the original purpose of a restriction no longer exists may indicate that the purpose of such cancellation is noncompensatory. Thus, for example, if a so-called “buy-sell” restriction was imposed on a corporation’s stock to limit ownership of such stock and is being cancelled in connection with a public offering of the stock, such cancellation will generally be regarded as noncompensatory. However, the mere fact that the employer is willing to forego a deduction under section 83(h) is insufficient evidence to establish a noncompensatory cancellation of a nonlapse restriction. The refusal by a corporation or shareholder to repurchase stock of the corporation which is subject to a permanent right of first refusal will generally be treated as a cancellation of a nonlapse restriction. The preceding sentence shall not apply where there is no nonlapse restriction, for example, where the price to be paid for the stock subject to the right of first refusal is the fair market value of the stock. Section 83(d)(2) and this (1) do not apply where immediately after the cancellation of a nonlapse restriction the property is

still substantially nonvested and no section 83(b) election has been made with respect to such property. In such a case the rules of section 83(a) and § 1.83-1 shall apply to such property.

(2) *Evidence of noncompensatory cancellation.* In addition to the information necessary to establish the factors described in paragraph (b)(1) of this section, the taxpayer shall request the employer to furnish the taxpayer with a written statement indicating that the employer will not treat the cancellation of the nonlapse restriction as a compensatory event, and that no deduction will be taken with respect to such cancellation. The taxpayer shall file such written statement with his income tax return for the taxable year in which or with which such cancellation occurs.

(c) *Examples.* The provisions of this section may be illustrated by the following examples:

Example 1. On November 1, 1971, X corporation whose shares are closely held and not regularly traded, transfers to E, an employee, 100 shares of X corporation stock subject to the condition that, if he desires to dispose of such stock during the period of his employment, he must resell the stock to his employer at its then existing book value. In addition, E or E's estate is obligated to offer to sell the stock at his retirement or death to his employer at its then existing book value. Under these facts and circumstances, the restriction to which the shares of X corporation stock are subject is a nonlapse restriction. Consequently, the fair market value of the X stock is includible in E's gross income as compensation for taxable year 1971. However, in determining the fair market value of the X stock, the book value formula price will ordinarily be regarded as being determinative of such value.

Example 2. Assume the facts are the same as in example (1), except that the X stock is subject to the condition that if E desires to dispose of the stock during the period of his employment he must resell the stock to his employer at a multiple of earnings per share that is in this case a reasonable approximation of value at the time of transfer to E. In addition, E or E's estate is obligated to offer to sell the stock at his retirement or death to his employer at the same multiple of earnings. Under these facts and circumstances, the restriction to which the X corporation stock is subject is a nonlapse restriction. Consequently, the fair market value of the X stock is includible in E's gross income for taxable year 1971. However, in determining the fair market value of the X

stock, the multiple-of-earnings formula price will ordinarily be regarded as determinative of such value.

Example 3. On January 4, 1971, X corporation transfers to E, an employee, 100 shares of stock in X corporation. Each such share of stock is subject to an agreement between X and E whereby E agrees that such shares are to be held solely for investment purposes and not for resale (a so-called investment letter restriction). E's rights in such stock are substantially vested upon transfer, causing the fair market value of each share of X corporation stock to be includible in E's gross income as compensation for taxable year 1971. Since such an investment letter restriction does not constitute a nonlapse restriction, in determining the fair market value of each share, the investment letter restriction is disregarded.

Example 4. On September 1, 1971, X corporation transfers to B, an independent contractor, 500 shares of common stock in X corporation in exchange for B's agreement to provide services in the construction of an office building on property owned by X corporation. X corporation has 100 shares of preferred stock outstanding and an additional 500 shares of common stock outstanding. The preferred stock has a liquidation value of \$1,000x, which is equal to the value of all assets owned by X. Therefore, the book value of the common stock in X corporation is \$0. Under the terms of the transfer, if B wishes to dispose of the stock, B must offer to sell the stock to X for 150 percent of the then existing book value of B's common stock. The stock is also subject to a substantial risk of forfeiture until B performs the agreed-upon services. B makes a timely election under section 83(b) to include the value of the stock in gross income in 1971. Under these facts and circumstances, the restriction to which the shares of X corporation common stock are subject is a nonlapse restriction. In determining the fair market value of the X common stock at the time of transfer, the book value formula price would ordinarily be regarded as determinative of such value. However, the fair market value of X common stock at the time of transfer, subject to the book value restriction, is greater than \$0 since B was willing to agree to provide valuable personal services in exchange for the stock. In determining the fair market value of the stock, the expected book value after construction of the office building would be given great weight. The likelihood of completion of construction would be a factor in determining the expected book value after completion of construction.

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